

Message Text

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ACTION SS-15

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FOR UNDER SECRETARY COOPER AND EUR/SE

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TAGS: EAID, EFIN, IMF, GR
SUBJECT: TEXT OF ZOLOTAS PROPOSAL FOR INTERNATIONAL LOAN
INSURANCE FUND

REF: ATHENS 527

1. FOLLOWING IS THE TEXT OF GOVERNOR ZOLOTAS' PROPOSAL FOR
EUROCREDIT INSURANCE, ADVANCED FOR UNDER SECRETARY COOPER'S
MEETING WITH MR. VRANOPOULOS (REFTEL):
BEGIN TEXT.

INTRODUCTORY REMARKS AND AN OUTLINE FOR THE ESTABLISHMENT OF AN
INTERNATIONAL LOAN INSURANCE FUND BY XENOPHON ZOLOTAS, GOVERNOR
OF THE BANK OF GREECE AND GOVERNOR OF THE IMF FOR GREECE
ATHENS, JANUARY 3, 1978

THE RATE OF GROWTH AND THE VOLUME THAT INTERNATIONAL COMMER-
CIAL BANK CREDIT HAS REACHED IN THE LAST FEW YEARS IS OF SUCH
MAGNITUDE THAT FEW FINANCIAL EXPERTS, AS LITTLE AS TEN YEARS AGO,
WOULD HAVE IMAGINED. THE GROSS VOLUME OF THIS MARKET, AS RECORDED
BY THE BIS, STOOD AT \$548 BILLION AT THE END OF 1976. DURING THAT
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SAME YEAR IT GREW BY \$105 BILLION OR 24 PERCENT. IN PARTICULAR,
TOTAL COMMERCIAL BANK CLAIMS ON COUNTRIES OTHER THAN THE GROUP
OF TEN AND OFFSHORE BANKING CENTRES AMOUNTED TO \$193 BILLION AT
THE END OF THE FIRST QUARTER OF 1977, AN INCREASE OF \$44 BILLION
OR 30 PERCENT FROM THE PREVIOUS YEAR. NON-OIL LESS DEVELOPED
COUNTRIES ALONE OWE WESTERN BANKS SOME \$83 BILLION OUT OF A
TOTAL EXTERNAL DEBT WHICH STOOD AT \$180 BILLION AT THE END OF

1976 AND WHICH, THE UNCTAD SECRETARIAT PROJECTS, MIGHT RISE TO AS MUCH AS \$253 BILLION BY THE END OF 1978.

THESE COMMERCIAL CAPITAL FLOWS, IN CONJUNCTION WITH OFFICIAL FINANCING, HAVE CONTRIBUTED IMMEASURABLY TO THE EXPANSION OF WORLD TRADE AND THE FINANCING OF BALANCE OF PAYMENTS DEFICITS OF MANY DEVELOPING AND OF SOME DEVELOPED COUNTRIES. IT WOULD BE IN THE INTEREST OF THE INTERNATIONAL FINANCIAL COMMUNITY AT LARGE FOR THE PRIVATE BANKING SECTOR TO CONTINUE TO PLAY ITS MOST VALUABLE ROLE IN THE FUTURE, AS AN INTEGRAL PART OF A SMOOTHLY FUNCTIONING INTERNATIONAL FINANCIAL SYSTEM.

THE ENORMOUS EXPANSION OF COMMERCIAL BANK LENDING CAN BE TRACED IN PART TO THE OIL CRISIS OF 1973. THE RISE IN THE PRICE OF OIL HAS PRODUCED A RADICAL REALIGNMENT OF INTERNATIONAL FINANCIAL RELATIONS WHOSE IMPLICATIONS SHOULD BE CAREFULLY EXAMINED. THE OIL EXPORTING COUNTRIES REPLACED THE INDUSTRIAL ONES AS THE MAIN SOURCE OF DEVELOPMENT FUNDS AS WELL AS FUNDS FOR FINANCING PAYMENTS IMBALANCES. THE OIL PRODUCERS, HOWEVER, LACK TWO BASIC CHARACTERISTICS WHICH THE INDUSTRIAL COUNTRIES HAD IN THE PAST. FIRST, HAVING A LOW POPULATION AND INDUSTRIAL BASE, THEY WERE UNABLE TO ABSORB THE DEFICITS RUN BY OTHER COUNTRIES IN ORDER TO PAY FOR THEIR OIL BILLS. SECOND, THEY DID NOT POSSESS THE INSTITUTIONAL MECHANISMS NEEDED TO CHANNEL THEIR SURPLUS FUNDS TO LONGER TERM INVESTMENTS OUTSIDE OF THEIR TERRITORIES. THUS, THEY DID NOT HAVE ANY OTHER ALTERNATIVE BUT TO USE THE LIMITED OFFICIAL USE

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BANKING SECTOR OF THE DEVELOPED COUNTRIES AS THE MAIN DEPOSITORY OF THEIR SURPLUS FUNDS. FURTHERMORE, THE SHEER SIZE OF THE NEEDS OF DEVELOPING COUNTRIES TO PAY FOR THEIR INCREASED OIL BILLS BUT ALSO TO FUND THEIR DEVELOPMENT RENDERED THE EXISTING OFFICIAL SOURCES OF ASSISTANCE INSUFFICIENT TO MEET THESE NEEDS. THE BANKS, ON THE OTHER HAND, WERE WILLING TO UNDERTAKE THE TASK OF RECYCLING THE SURPLUS OIL-FUNDS. BY SO DOING THEY PROVIDED MUCH NEEDED CAPITAL TO THE DEVELOPING WORLD AND AT THE SAME TIME MAINTAINED FOREIGN DEMAND FOR THE EXPORTS OF THE DEVELOPED COUNTRIES. IF WE WANT TO SUSTAIN WORLD TRADE AND ECONOMIC ACTIVITY THIS ROLE OF COMMERCIAL BANKING SHOULD BE MAINTAINED.

THESE STRUCTURAL IMBALANCES, WHICH ARE NOT LIKELY TO DISAPPEAR IN THE FUTURE, RESULTED IN THE PRIVATE BANKING SECTOR ALREADY FINANCING THREE QUARTERS OF THE TOTAL BALANCE OF PAYMENTS DEFICITS. THIS RATIO OF PRIVATE TO OFFICIAL FINANCING IS EXPECTED TO FURTHER DETERIORATE.

THE QUESTION THEN ARISES: ARE WE TO STAND BY ALLOWING THE UNCONTROLLED PYRAMIDING OF PRIVATE COMMERCIAL LENDING, OR ARE WE TO TAKE THE NECESSARY MEASURES TO STRENGTHEN THIS MARKET AND ASSURE THE SMOOTH FUNCTIONING OF WORLD CAPITAL FLOWS? WE THINK

THE LATTER IS THE CORRECT COURSE. ALTHOUGH PROPHECIES OF IMPENDING DOOM DO NOT SEEM TO BE WARRANTED, LEGITIMATE REASONS FOR CONCERN DO EXIST AND HAVE TO BE ELIMINATED FOR THE BENEFIT OF BOTH THE LENDERS AND THE BORROWERS.

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IT IS NOT ADVISABLE THAT INTERNATIONAL COMMERCIAL BANKS CARRY A DISPROPORTIONATE SHARE OF RECYCLING FUNDS TO THE DEVELOPING WORLD AND THE INDUSTRIAL COUNTRIES WITH CHRONIC BALANCE OF PAYMENTS DEFICITS. SOME MAJOR INTERNATIONAL BANKING INSTITUTIONS HAVE ALREADY EXPOSED THEMSELVES IN LOANS WHICH IN THE AGGREGATE ARE FAR BEYOND THE ABILITY OF THE RESPECTIVE CENTRAL BANKS TO SERVE AS LENDERS OF LAST RESORT. ATTENTION SHOULD BE FOCUSED ALSO ON THE MATURITY STRUCTURE OF COMMERCIAL LENDING. IT IS WELL KNOWN THAT EUROMARKETS ARE CHARACTERIZED BY A SIGNIFICANT MISMATCHING OF LIQUID DEPOSITS AND ILLIQUID LOAN COMMITMENTS. DESPITE THIS, MOST EUROLOANS ARE NOT SUITED TO THE FINANCING NEEDS OF DEVELOPING COUNTRIES WHICH REQUIRE EVEN LONGER-TERM CREDITS.

THESE POTENTIAL SOURCES OF INSTABILITY COULD CONCEIVABLY WEAKEN THE FOUNDATION OF THIS MARKET, WHICH IS THE CONFIDENCE OF ALL PARTICIPANTS IN ITS SOUNDNESS AND VIABILITY. FOR INSTANCE, A LOAN MORATORIUM OR AN INSOLVENCY BY A COUNTRY WITH HEAVY EXTERNAL DEBTS, MIGHT PRECIPITATE A MAJOR FINANCIAL CRISIS. THE INTERNATIONAL FINANCIAL MARKETS HAVE BECOME SO INTERLINKED THAT THE EVENT OF AN INSOLVENCY OR LACK OF LIQUIDITY ON THE PART OF A MAJOR PRIVATE FINANCIAL INSTITUTION MIGHT UNLEASH CHAIN REACTIONS THAT COULD CRIPPLE THE INTERNATIONAL FINANCIAL SYSTEM.

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A FINANCIAL COLLAPSE WILL NOT ONLY AFFECT A FEW BANKS AND THEIR DEPOSITORS. IT MIGHT, LIKE THE STOCK MARKET CRASH OF 1929, LEAD TO A DEPRESSION FOR THE ECONOMIES OF THE INDUSTRIALIZED WORLD AND TO A HALT OF THE DEVELOPMENT PROCESS OF THE LESS-DEVELOPED COUNTRIES. THUS, IT IS THE COMMON INTEREST OF BOTH THE DEVELOPED AND THE DEVELOPING WORLD TO TAKE MEASURES TO PREVENT THE DELICATELY BALANCED STRUCTURE OF INTERNATIONAL FINANCE FROM COMING APART.

MANY OBSERVERS OF THE INTERNATIONAL FINANCIAL SCENE HAVE CONCERNED THEMSELVES WITH EXPLORING METHODS OF UTILIZING THE FINANCIAL RESOURCES OF COMMERCIAL BANKS IN SUCH A WAY THAT WILL NOT JEOPARDIZE THE STABILITY OF THE WHOLE SYSTEM. IN THIS RESPECT, SEVERAL WORTHWHILE PROPOSALS HAVE BEEN PUT FORWARD.

IN A SIMILAR VEIN, WE HAVE SUGGESTED DURING THE 1977 IMF-IBRD MEETINGS AN INSURANCE AGENCY TO PROVIDE GUARANTEES FOR PRIVATE INTERNATIONAL LOANS WHICH WOULD SERVE A DUAL PURPOSE. FIRST, IT WOULD ACT AS A FIRE BRIGADE QUELLING THE POTENTIAL FINANCIAL DIFFICULTIES OF A BORROWER. THUS, IT COULD PREVENT THE OCCURRENCE OF CHAIN REACTIONS LEADING TO A MAJOR INTERNATIONAL FINANCIAL CRISIS. SECOND, IT COULD SECURE AND ENLARGE THE FLOW OF DEVELOPMENT FUNDS FROM THE PRIVATE CAPITAL MARKETS TOWARD THE DEVELOPING COUNTRIES. THIS WILL BE IN ADDITION TO THE CURRENT AID FLOWING TO THESE COUNTRIES, WHICH WILL NOT BE AFFECTED BY THIS PROPOSAL.

THE MAJOR ADVANTAGES OF SUCH A SCHEME TO THE DEVELOPING COUNTRIES ARE OBVIOUS, GIVEN THEIR HUGE NEED FOR CAPITAL RESOURCES. IN ADDITION TO INCREASING PRIVATE CAPITAL FLOWS TO THE LDCS THE PROPOSED PLAN WILL IMPROVE THE AVAILABILITY OF CREDIT AND BORROWING CONDITIONS TO THEM. MOREOVER IT WILL OPEN THE

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COMMERCIAL CREDIT WINDOW TO MANY LOW-INCOME LDCS WHICH ARE TODAY EXCLUDED FROM THE PRIVATE INTERNATIONAL CAPITAL MARKETS, DUE TO THEIR INABILITY IN MEETING THE "CREDIT-WORTHINESS CRITERIA" OF PRIVATE INSTITUTIONS.

TO THE INDUSTRIALIZED COUNTRIES, ON THE OTHER HAND, IT WILL PROVIDE THE MEANS OF ENHANCING THE DEMAND FOR THEIR EXPORTS AND SUPPORTING THE STEADY EXPANSION OF THEIR ECONOMIES AS WELL AS INTERNATIONAL TRADE.

THE GUIDING PRINCIPLES OF THE PROPOSED INSURANCE SCHEME
ARE THE FOLLOWING:

(1) THE INFORMATION AVAILABLE TO INTERNATIONAL LENDERS SHOULD
BE IMPROVED. HOWEVER, THE DATA KNOWN TO INTERNATIONAL AGENCIES
(E.G. IMF, IBRD, BIS) CANNOT BE RELEASED TO PRIVATE BANKS WITHOUT
IMPAIRING THE FUTURE FLOW AND QUALITY OF SUCH DATA. IT IS ADVIS-
ABLE THEREFORE, THAT THIS INFORMATION BE MADE AVAILABLE ONLY TO
THE INTERNATIONAL ORGANIZATION WHICH WOULD GUARANTEE PRIVATE LOANS.

(2) THE PROPOSED SCHEME SHOULD OPERATE EXCLUSIVELY ON THE
BASIS OF SOUND BANKING PRINCIPLES, AND RARELY EXTENSIVELY ON THE
EXPERIENCE OF NATIONAL EXPORT CREDIT ORGANIZATIONS. THE PURPOSE
IS NOT TO ELIMINATE RISK IN COMMERCIAL LENDING BUT RATHER TO
ENABLE BANKS TO RESPOND TO LEGITIMATE CREDIT DEMANDS.

(3) THE INSURANCE SCHEME SHOULD NOT BE EXCESSIVELY BURDENSOME
ON THE COUNTRIES PROVIDING THE GUARANTEES, GIVEN THE BUDGETARY
CONSTRAINTS WHICH THEY FACE. THEREFORE, GUARANTEES SHOULD BE
PARTIAL AND SUPPORTED BY A CALLABLE, NOT PAID-OUT CAPITAL, WHICH
WILL BE A FRACTION OF THE TOTAL GUARANTEES GIVEN.

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(4) THRESHOLD COUNTRIES SHOULD BE ASSISTED TO GRADUATE TO THE
GROUP OF COUNTRIES THAT HAVE ACCESS TO CAPITAL MARKETS.

PAST EXPERIENCE SHOWS THAT LOSS RATIOS ON INTERNATIONAL
COMMERCIAL LENDING HAVE BEEN WELL BELOW SIMILAR RATIOS ON
DOMESTIC LOANS. ALTHOUGH WE DO KNOW THAT PAST HISTORY IS NOT
ALWAYS THE BEST GUIDE FOR THE FUTURE, NEVERTHELESS, IT SHOULD BE
EXPECTED THAT THE GUARANTEES PROPOSED IN THIS SCHEME WILL BE VERY

INFREQUENTLY, IF EVER, CALLED. THE SUCCESS OF THIS PROPOSAL, HOWEVER, SHOULD NOT BE MEASURED BY THE AMOUNT OF LOANS COVERED, BUT RATHER BY THE EXTENT TO WHICH IT HELPS TO MAINTAIN A STABLE INTERNATIONAL FINANCIAL ORDER.

D R A F T

FOOTNOTE(1)

INTERNATIONAL LOAN INSURANCE FUND

1. OBJECTIVES OF THE "FUND"
TO STRENGTHEN INTERNATIONAL FINANCIAL MARKETS AND EXPAND THE FLOW OF FUNDS TO DEVELOPING COUNTRIES.

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2. MEMBERSHIP OF THE "FUND"
MEMBERSHIP IS OPEN TO ALL IMF MEMBER COUNTRIES.

3. GUARANTORS
A. ALL MEMBERS OF THE "FUND", EXCEPT THOSE WITH A PER CAPITA INCOME, OR QUOTA IN THE IMF, BELOW CERTAIN LEVELS WHICH WILL BE REVISED PERIODICALLY.
B. ALTERNATIVELY: THE HIGHLY INDUSTRIALIZED AND SURPLUS OPEC COUNTRIES.

4. RECIPIENT COUNTRIES
ALL MEMBERS CONFORMING TO SPECIFIC RULES AND REGULATIONS OF THE "FUND" TO BE FORMULATED.

5. QUOTAS
EACH GUARANTOR IS ASSIGNED A QUOTA DENOMINATED IN SDRS. QUOTAS DETERMINE THE LIMITS FOR CAPITAL CALLS ON THE GUARANTORS.

6. LIABILITY OF THE "FUND"
THE OVERALL LIABILITY OF THE "FUND" WILL BE LIMITED TO A CONSERVATIVE MULTIPLE OF THE TOTAL QUOTAS OF THE GUARANTORS.

7. ELIGIBILITY OF LOANS
GUARANTEES WILL BE RESTRICTED TO FINANCIALLY SOUND BALANCE OF PAYMENTS AND DEVELOPMENT LOANS (FOOTNOTE 2).

8. ELIGIBILITY OF LENDING INSTITUTIONS
ALL MAJOR INTERNATIONAL LENDING INSTITUTIONS DEEMED TO BE APPLYING SOUND BANKING PRACTICES WILL BE ELIGIBLE.

9. INFORMATION
THE "FUND" WILL SHARE INFORMATION WITH OTHER INTERNATIONAL ORGANIZATIONS, INCLUDING THE IMF, THE IBRD AND THE BIS. MORE-

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OVER, IT WILL BE EMPOWERED TO OBTAIN DATA AVAILABLE TO PRIVATE LENDING INSTITUTIONS.

10. SHARING OF LIABILITY AND RISK AMONG GUARANTORS
THE LIABILITY AND RISK INVOLVED IN THE GUARANTEES WILL BE UNDERTAKEN COLLECTIVELY BY THE GUARANTOR COUNTRIES; EACH COUNTRY'S SHARE WILL BE IN PROPORTION TO ITS QUOTA. THE IBRD COULD BE AUTHORIZED TO PARTICIPATE AS A PARTIAL GUARANTOR; THIS IS PERMITTED BY ITS PRESENT BY-LAWS.

11. PERCENTAGE OF LOAN COVERAGE
A. GUARANTEES COULD BE A FIXED PERCENTAGE OF THE RESPECTIVE LOANS.
B. ALTERNATIVELY: THE PERCENTAGE OF COVERAGE, UP TO A MAXIMUM CEILING (E.G. 70 PER CENT), COULD BE NEGOTIATED BETWEEN THE LENDING INSTITUTION AND THE "FUND".
C. EXCEPTIONALLY, LOANS TO DEVELOPING COUNTRIES WITHOUT ACCESS TO PRIVATE CAPITAL MARKETS COULD BE COVERED UP TO 90 PERCENT, PROVIDED THEY SATISFY THE CONDITIONS STATED IN PARAGRAPHS 4 AND 7. IN SOME CASES, THE COVERAGE COULD BE INCREASED TO 100 PER CENT OF THE LOAN, BUT THERE WOULD BE A PREDETERMINED OVERALL LIMIT FOR SUCH GUARANTEES (E.G. 10 PER CENT OF THE TOTAL QUOTAS OF THE GUARANTORS).

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12. DETERMINATION OF INSURANCE PREMIA

THE BORROWING COUNTRY WILL BE REQUIRED TO PAY, ON THE ENTIRE AMOUNT OF THE LOAN, THE FULL CHARGE WHICH WOULD HAVE BEEN LEVIED IN THE ABSENCE OF A GUARANTEE. THE LENDING INSTITUTION WILL TURN OVER TO THE "FUND" AS THE INSURANCE PREMIUM THE DIFFERENCE BETWEEN: (1) THE INTEREST COST PAID ON THE GUARANTEED PART OF THE LOAN AND (2) THE COMPARABLE COST TO PRIME BORROWERS, AS DETERMINED BY THE MARKET. IN CASES OF 100 PERCENT COVERAGE OF A LOAN (PARAGRAPH 11C) THE PREMIUM WILL BE A SMALL CHARGE ABOVE THE COST TO PRIME BORROWERS.

13. PROCEDURE FOR THE ISSUANCE OF QUARANTEES

- A. APPLICATIONS MAY BE SUBMITTED BY EITHER THE LENDING INSTITUTION OR THE RECIPIENT COUNTRY.
- B. GUARANTEES WILL BE ISSUED IN THE CURRENCY OF THE LOAN.

14. PROCEDURE IN THE EVENT OF DEFAULT

- A. THE EXISTENCE OF A DEFAULT WILL BE DECLARED ONLY AFTER A MANDATORY CONSULTATION AMONG THE "FUND", THE PRIVATE LENDING INSTITUTION AND THE BORROWER.
- B. THE GUARANTEE WILL BE PAID FROM THE INSURANCE PREMIA AND OTHER INCOME OF THE "FUND", BUT IF THESE RESOURCES PROVE INSUFFICIENT CALLS WILL BE MADE ON THE GUARANTORS IN PROPORTION TO THEIR LIMITED OFFICIAL USE

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QUOTAS.

- C. THE "FUND" WILL CONSULT WITH THE DEFAULTING COUNTRY TO WORK OUT AN APPROPRIATE REPAYMENT SCHEDULE; ANY RECOVERIES WILL BE CREDITED FIRST TO THE AMOUNTS PAID BY THE GUARANTORS.

15. ORGANIZATION AND MANAGEMENT

THE "FUND" WILL HAVE ITS OWN MANAGEMENT AND STAFF, BUT IN ORDER TO REDUCE ADMINISTRATIVE EXPENSES TO A MINIMUM IT COULD USE THE FACILITIES OF THE IMF, THE IBRD AND THE BIS.

16. PRIVILEGES AND IMMUNITIES

17. LIQUIDATION

END TEXT.

FOOTNOTE 1-- HEREINAFTER REFERRED TO AS "FUND".

FOOTNOTE 2 -- PROJECT LOANS WHICH ARE FINANCED BY IBRD WILL NOT BE COVERED BY THE "FUND".

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